Report

of the

Examination of

Homestead Mutual Insurance Company

Oshkosh, Wisconsin

As of December 31, 2003

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State of Wisconsin / OFFICE OF THE COMMISSIONER OF INSURANCE

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December 10, 2004

Honorable Jorge Gomez
Commissioner of Insurance
State of Wisconsin
125 South Webster Street
Madison, Wisconsin 53702

Commissioner:

In accordance with your instructions, an examination has been performed as of December 31, 2003, of the affairs and financial condition of:

HOMESTEAD MUTUAL INSURANCE COMPANY
Oshkosh, Wisconsin

and the following report thereon is respectfully submitted:

I. INTRODUCTION

The previous examination of Vinland Mutual Insurance Company, now named Homestead Mutual Insurance Company (the company) was made in 1999 as of December 31, 1998. The current examination covered the intervening time period ending December 31, 2003, and included a review of such subsequent transactions deemed essential to complete this examination.

The “Summary of Examination Results” contains elaboration on all areas of the company's operations. Special attention was given to the action taken by the company to satisfy the recommendations and comments made in the previous examination report.

The company has undergone two mergers since the last examination. The surviving company, Homestead Mutual Insurance Company (Homestead), was originally organized as a town mutual insurance company named Vinland Town Mutual Insurance Company (Vinland) on June 25, 1873, under the provisions of the then existing Wisconsin Statutes. The first company to merge with Vinland was Winchester Mutual Insurance Company (Winchester), which was originally organized as a town mutual insurance company on February 20, 1875. The second company merged was Nekimi Mutual Insurance Company (Nekimi), which was originally organized as a town mutual insurance company on January 29, 1884.

On June 17, 1999, Vinland and Winchester applied to the Wisconsin Commissioner of Insurance for approval to merge pursuant to s. 612.21, Wis. Stat., and to change the name of the surviving corporation to Homestead Mutual Insurance Company effective September 1, 1999.

On February 7, 2000, Homestead and Nekimi applied to the Wisconsin Commissioner of Insurance for approval to merge pursuant to s. 612.21, Wis. Stat., effective May 1, 2000, with the surviving corporation being Homestead.

During the period under examination, and due to the mergers, the company amended its articles of incorporation to increase its writing territory to include six new counties, increase its number of members on its board of directors to sixteen with the reduction by attrition until the number reaches nine, limit the policyholder’s assessment to the amount of their annual premium, and deleted the article 8.3 on implied amendments.

The company is currently licensed to write property, including windstorm and hail, and nonproperty insurance in the following counties:

Brown	Portage
Calumet	Shawano
Dodge	Sheboygan
Fond du Lac	Washington
Green Lake	Waupaca
Manitowoc	Waushara
Marquette	Winnebago
Outagamie	

A review was made of the policy and application forms currently used by the company. The company issues approved policies with or without endorsements for terms of one year with premiums payable on the advance premium basis. The company also charges a policy fee equal to $15 for premiums less than $500, $30 for premiums between $501 and $1,000, and $45 for premiums in excess of $1,000.

Business of the company is acquired through thirty-eight agents, nine of whom are directors or retired directors of the company. Director agents receive a commission of 11% on their policies while non-director agents receive a commission of 12%.

Non-director agents have no authority to adjust losses. Losses are adjusted by one of Homestead's in-house adjusters. Directors can be used if the adjusters require assistance. Losses handled by the adjusters in excess of $5,000 are approved by the General Manager. The director adjusters are paid $25 per adjustment while the in-house adjusters are salaried. Mileage reimbursement is paid at $.375 per mile.

Policyholders may participate in the management and control of the company by attending and voting at all annual or special meetings of the members. No member may vote by proxy. The annual meeting of the company for the election of directors and special meetings of the company are held in accordance with its articles of incorporation.

Board of Directors

The board of directors consists of eleven members divided into three classes. One class is elected at each annual meeting for a term of three years. Vacancies on the board may be filled by the directors for the interim to the next annual meeting when a director shall be chosen for the unexpired term. The company has elected to not replace retiring directors until they reach seven directors.

The current board of directors consists of the following policyholders of the company:

Name	Principal Occupation	Residence	Expiry
George A. Tipler*	General Manager/Agent	Oshkosh, WI	2005
Jack Zeller*	Farming/Agent	Oshkosh, WI	2005
Dale Wilde	Farming	Oshkosh, WI	2006
Dallas Niemuth*	Company Underwriter/Agent	Larsen, WI	2005
Darwin Krenke*	Farming/Agent	Fremont, WI	2007
Jeff Selle	Company Inspector/Loss Adjuster	Winneconne, WI	2006
Lola Schroeder*	School Bus Driver/Agent	Fremont, WI	2006
Daryl Jensen	Retired	Oshkosh, WI	2007
Neal Meltz*	Retired/Agent	Oshkosh, WI	2005
Karen Stahmann*	Company Policy Issuance/Agent	Van Dyne, WI	2007
Pat Brennand*	Farming/Agent	Oshkosh, WI	2005

Directors who are also agents and receive policy commissions are identified with an asterisk.

Members of the board currently receive $20 per diem for committee and board meetings attended and mileage reimbursement is paid at $.375 per mile.

Officers

Officers are elected by the board of directors from among its members and hold office for one year or until their successors are duly elected and qualified. Officers serving at the present time and their 2003 salaries are as follows:

Name	Office	2003 Salary
Jack Zeller	President	$ 1,641
Dale Wilde	Vice-President	228
George A. Tipler	Secretary & General Manager	66,392*
Dallas Niemuth	Treasurer & Underwriter	39,857

* Includes $25,000 Secretary salary and policy commissions but does not include $15,958 received for office rent.

Committees of the Board

The company's bylaws allow for the formation of certain committees by the board of directors. The committees at the time of the examination are listed below:

Underwriting Committee
Dallas Niemuth, Chairman
Jack Zeller
Neal Meltz
Lola Schroeder
George Tipler
Pat Brennand
Karen Stahmann

Loss Committee
George Tipler, Chairman
Ron Miller
Dallas Niemuth
Dale Wilde

Long Range Planning Committee
Jack Zeller, Chairman
Neal Meltz
Dale Wilde
Lola Schroeder
George Tipler

Investment Committee
Jack Zeller, Chairman
Dale Wilde
George Tipler
Dallas Niemuth

Growth of Company

The growth of the company since the previous examination as compiled from its filed annual statements was as follows:

Year	Net Premiums Earned	Policies In Force	Net Income	Admitted Assets	Policyholders' Surplus
2003	$741,108	2,867	$226,772	$4,049,028	$3,205,611
2002	505,521	2,661	(408,689)	3,792,054	3,048,778
2001	492,274	2,508	(383,243)	4,121,298	3,649,509
2000	501,807	2,534	(298,080)	4,584,016	4,071,050
1999	476,700	2,636	(153,883)	4,792,662	4,138,170
1998	506,800	2,702	(67,945)	4,809,795	4,364,221

The ratios of gross and net premiums written to surplus as regards policyholders since the previous examination were as follows:

Year	Gross Premiums Written	Net Premiums Written	Ending Surplus	Writings Ratios	
				Net	Gross
2003	$1,397,133	$834,433	$3,205,611	44%	26%
2002	1,182,081	585,693	3,048,778	39	19
2001	1,026,981	506,828	3,649,509	28	14
2000	969,977	511,196	4,071,050	24	13
1999	969,025	518,996	4,138,170	23	12
1998	877,300	493,459	4,364,221	20	11

For the same period, the company's operating ratios were as follows:

Year	Net Losses and LAE Incurred	Other Underwriting Expenses Incurred	Net Underwriting Gain/Loss	Loss Ratio	Expense Ratio	Com-posite Ratio
2003	$224,030	$496,811	$ 20,267	30%	60%	90%
2002	516,612	545,529	(556,620)	102	93	195
2001	596,740	456,200	(560,666)	121	90	211
2000	578,398	412,948	(489,539)	115	81	196
1999	485,319	388,214	(396,833)	102	75	177
1998	508,083	332,174	(333,457)	100	67	168

The company has had positive net income only once in the past five years and surplus has decreased 27% from the $4,364,221 reported at the last examination to $3,205,611 at December 31, 2003. Admitted assets decreased 16% to $4,049,028 over the same period. The decrease in surplus and assets can be attributed not only to high net loss and loss adjustment expense ratios, which were exacerbated by storm losses in 2000 and 2001, but also to high underwriting expense ratios. During the period under examination, the company's net loss and loss adjustment expense ratio has averaged 30 percentage points greater than the average for the Wisconsin town mutual industry as a whole. The company's net underwriting expense ratio has been as high as 50 percentage points greater than the average for the Wisconsin town mutual industry as a whole and during the period under examination it averaged 37 percentage points greater than the average total for the Wisconsin town mutual industry. With the decline in interest rates, the company's investment income has been insufficient to offset underwriting and expense results as had been the case for some period of time prior to calendar year 1998.

Management stated they were aware of the company's high net losses and loss adjustment expense ratios and high underwriting ratios and has sought to address this situation during the period under examination. In 2001, the company developed a business plan, which it revised in 2003. In 2003, Wisconsin Reinsurance Corporation sent a letter to the managers of the Wisconsin town mutuals that it reinsured, offering suggestions on how to improve financial results. The company reviewed these suggestions and took measures to implement most of them where it had not done so already.

In 2003, management decided that measures needed to be taken to counter the company's unusually high underwriting expense ratios. The company laid off one employee, imposed salary reductions, reduced the agent commission base rate, reduced director per diems, and made other expense reductions where opportunities were identified. OCI and the company's management agree that there is more work to be done to reduce underwriting expenses.

Although in 2003, the company reported its first underwriting gain in the last ten years and its first positive net income during the period under examination, 2004 saw a resumption of the company's adverse financial trend. It is suggested that the board of directors and management of the company review pricing in relation to its loss and loss adjustment expense experience and necessary underwriting expenses in relation to the amount of business written.

II. REINSURANCE

The examiners' review of the company's reinsurance portfolio revealed there is currently one ceding treaty. The treaty contained a proper insolvency clause and complied with s. Ins 13.09 (3), Wis. Adm. Code, concerning maximum wind loss. Company retentions of risk complied with s. Ins 13.06, Wis. Adm. Code.

Reinsurer:	Wisconsin Reinsurance Corporation
Effective date:	January 1, 2004, continuous
Termination provisions:	Either party may terminate the contract and/or its exhibits as of any subsequent January 1 by giving to the other party at least 90 days advance notice in writing.

The coverages provided under this treaty are summarized as follows:

1.	Type of contract:	Class A – Casualty Excess of Loss and Stop Loss
	Lines reinsured:	All Casualty business written by the company
	Company's retention:	Excess of Loss: $5,000 each and every loss occurrence. A deductible of $1,000 may apply for raw milk contamination. Stop Loss: Annual aggregate net losses equal to 55% of the net casualty premiums written and subject to a minimum retention of $57,000.
	Coverage:	Excess of Loss: 100% of each and every loss, including loss adjustment expenses, in excess of the company net retention of $5,000 up to the maximum policy limits stated: a) $1,000,000 per occurrence, single limit, combined for bodily injury and property damage liability. b) $1,000,000 split limits, in any combination of bodily injury and property damage liability, and c) $5,000 for medical payments per person, $25,000 per accident. Stop Loss: 100% of annual aggregate net losses that exceed 55% of the net premiums written and in excess of the company's retention of $57,000.
	Reinsurance premium:	50% of the premium written The company shall remit premiums monthly. Premiums ceded are fully earned by the reinsurer, and the reinsurer carries no unearned premium reserve under the contract.

2.	Type of contract:	Class B – First Surplus
	Lines reinsured:	All property business written by the company
	Company's retention:	When the company’s retention is $400,000 or more in respect to a risk, the company may cede on a pro rata basis up to $800,000 of the risk. When the company’s retention is $400,000 or less in respect to a risk, the company may cede on a pro rata basis up to 50% of such risk.
	Coverage:	Pro rata portion of each and every loss, including loss adjustment expenses, up to $800,000 in excess of $400,000 when reinsured risk is equal to or greater than $400,000. When the risk is equal to or less than $400,000, coverage is the pro rata portion (up to 50%) of each and every loss, including loss adjustment expenses.
	Reinsurance premium:	Pro rata portion of premiums, fees and assessments charged by the company corresponding to the risks ceded under the agreement.
	Ceding commission:	Reinsurer shall make a commission allowance to the company of 15% of the premium paid to the reinsurer. Reinsurer shall pay the company a profit commission of 15% of the net profit during each accounting period.
3.	Type of contract:	Class C-1 – Excess of Loss
	Lines reinsured:	All property business written by the company
	Company's retention:	$30,000 each and every loss resulting from one loss occurrence with an annual aggregate deductible of $30,000.
	Coverage:	100% of any loss, including loss adjustment expenses, in excess of the company's retention of $30,000, subject to a limit of $70,000 per loss.
	Reinsurance premium:	Net premium written times [sum of the prior four years' losses incurred (paid and outstanding) by the reinsurer divided by the total net premiums written for the same period times 100/80ths], subject to the minimum and maximum rate limits. Minimum rate: 6% of current net premiums written. Maximum rate: 22% of current net premiums written. Current period rate: 13%. Deposit premium: $129,000, subject to a minimum of $103,000.

4.	Type of contract:	Class C-2 – Excess of Loss
	Lines reinsured:	All property business written by the company
	Company's retention:	$100,000 for each and every risk resulting from one loss occurrence.
	Coverage:	100% of any loss, including loss adjustment expenses, in excess of the company's retention of $100,000 up to $300,000 per loss occurrence.
	Reinsurance premium:	3% of current net premiums written in respect to the covered business. Deposit premium: $30,000, subject to a minimum of $24,000.
5.	Type of contract:	Class D/E – Stop Loss
	Lines reinsured:	All property business written by the company
	Company's retention:	Annual aggregate net losses, including loss adjustment expenses, equal to 70% of the net premiums written and subject to a minimum retention of $558,000.
	Coverage:	100% of annual aggregate net losses, including loss adjustment expenses, that exceeds 70% of the net premiums written and in excess of the company's retention.
	Reinsurance premium:	Net premium written times [sum of the prior eight years' losses incurred by the reinsurer divided by the total net premiums written for the same period times 100/80ths], subject to a minimum and maximum limits Minimum rate: 6% of current net premium written Maximum rate: 25% of current net premium written Current period rate: 15% Deposit premium: $149,400, subject to a minimum of $120,000.

III. FINANCIAL DATA

The following financial statements reflect the financial condition of the company as reported to the Commissioner of Insurance in the December 31, 2003, annual statement. Adjustments made as a result of the examination are noted at the end of this section in the area captioned "Reconciliation of Policyholders' Surplus."

Homestead Mutual Insurance Company
Statement of Assets and Liabilities
As of December 31, 2003

Assets	Ledger	Nonledger	Not Admitted	Net Admitted
Cash in company's office	$ 100	$	$	$ 100
Cash deposited in checking account	203,100			203,100
Cash deposited at interest	3,307			3,307
Bonds	2,074,857			2,074,857
Stocks and mutual fund investments	1,485,430			1,485,430
Premiums, agents' balances and installments:				
In course of collection	38,116		10,348	27,768
Deferred and not yet due	134,655			134,655
Investment income accrued		45,530		45,530
Reinsurance recoverable on paid losses and lae	59,905			59,905
Electronic data processing equipment	14,376			14,376
Furniture and fixtures	8,233		8,233	0
Totals	$4,022,079	$45,530	$18,581	$4,049,028

Liabilities and Surplus

Net unpaid losses	$ 84,646
Unpaid loss adjustment expenses	1,250
Commissions payable	23,404
Fire department dues payable	942
Unearned premiums	621,734
Reinsurance payable	83,668
Amounts withheld for the account of others	186
Other liabilities:	
Expense related:	
Accounts payable	845
Deferred Compensation	10,000
Non-expense related:	
Premiums received in advance	16,742
Total Liabilities	843,417
Policyholders' surplus	3,205,611
Total Liabilities and Surplus	$4,049,028

Homestead Mutual Insurance Company
Statement of Operations
For the Year 2003

Net premiums and assessments earned		$741,108
Deduct:		
Net losses incurred	$174,991	
Net loss adjustment expenses incurred	49,039	
Other underwriting expenses incurred	496,811	
Total losses and expenses incurred		720,841
Net underwriting gain (loss)		20,267
Net investment income:		
Net investment income earned	136,583	
Net realized capital gains	12,053	
Total investment gain (loss)		148,636
Other income:		
Policy Fees and miscellaneous income	57,784	
Gains (losses) on disposal of fixed assets	85	
Total other income		57,869
Net Income (Loss)		$226,772

Reconciliation and Analysis of Surplus as Regards Policyholders
For the Five-Year Period Ending December 31, 2003

The following schedule is a reconciliation of surplus as regards policyholders during the period under examination as reported by the company in its filed annual statements:

	2003	2002	2001	2000	1999
Surplus, beginning of year	$3,048,778	$3,649,509	$4,071,050	$4,138,170	$4,364,221
Net income	226,772	(408,689)	(383,243)	(298,080)	(153,883)
Net unrealized capital gains or (losses)	(62,865)	(193,138)	(42,170)	237,336	(72,738)
Change in non-admitted assets	(7,074)	1,096	3,872	(6,376)	570
Surplus, end of year	$3,205,611	$3,048,778	$3,649,509	$4,071,050	$4,138,170

Reconciliation of Policyholders' Surplus

The following schedule is a reconciliation of surplus as regards policyholders between that reported by the company and as determined by this examination:

Policyholders' surplus per December 31, 2003, annual statement			$3,205,611
	Increase	**Decrease**	
Net Unpaid Losses	$49,177	$ 0	
Net increase or (decrease)	$49,177	$ 0	49,177
Policyholders' Surplus per Examination			$3,254,788

IV. SUMMARY OF EXAMINATION RESULTS

Compliance with Prior Examination Report Recommendations

Comments and recommendations contained in the last examination report and the action taken on them by the company are as follows:

1. Underwriting—It is recommended that the company continually review and update its underwriting guidelines to reflect the company's current practices and lines of business.

   Action—Compliance.

2. Underwriting—It is recommended that the company establish a formal written inspection procedure for new and renewal business, whereby a sampling of new applications and renewal business is inspected by committee members independent of the risk under consideration.

   Action—Compliance.

3. Premium Booked But Deferred and Not Yet Due—It is recommended that the company properly report premiums booked but deferred and not yet due on all future annual statements.

   Action—Compliance.

4. Net Unpaid Losses—It is recommended that the company, for open claims, comply with the minimum standards for loss claim documentation as specified in s. Ins. 13.05 (4) (e), Wis. Adm. Code.

   Action—Compliance.

Current Examination Results

Corporate Records

The minutes of the annual meetings of policyholders and meetings of the board of directors and committees thereof, were reviewed for the period under examination and also for the subsequent period.

Biographical data relating to company officers and directors have been reported in accordance with the provisions of s. Ins 6.52, Wis. Adm. Code.

The company has executed formal written agreements with its agents. The contracts include language indicating the agent will represent the company's interests "in good faith."

Conflict of Interest

In accordance with a directive of the Commissioner of Insurance, each company is required to establish a procedure for the disclosure to its board of directors of any material interest or affiliation on the part of its officers, directors, or key employees which conflicts or is likely to conflict with the official duties of such person. A part of this procedure is the annual completion of a conflict of interest questionnaire by the appropriate persons. The company has adopted such a procedure for disclosing potential conflicts of interest. Conflict of interest questionnaires were reviewed for the period under examination with no apparent conflicts being noted.

Fidelity Bond and Other Insurance

The company is afforded coverage under the terms of the following bonds or contracts and has complied with s. Ins 13.05 (6), Wis. Adm. Code, which sets forth the minimum requirements for fidelity bond coverage:

Type of Coverage	Coverage Limits
Fidelity bond	$ 500,000
Worker's Compensation:	
Employee injury	Statutory
Employee liability:	
Each accident	100,000
Each employee	100,000
Policy limit	500,000
Combined Professional Liability and Directors & Officers Liability	2,000,000
Commercial Property—Business Property	30,000

Underwriting

The company has a written underwriting guide. The guide covers all the lines of business that the company is presently writing.

The company has a formal inspection procedure for both new and renewal business. A sampling of new applications and renewal business is inspected by committee members who are independent of the risk under consideration and review.

Claims Adjusting

The company has an adjusting committee consisting of at least three directors as required by s. 612.13 (4), Wis. Stat. The function of this committee is to adjust or supervise the adjustment of losses.

Accounts and Records

The examiners' review of the company's records indicated that the company is in compliance with s. Ins 13.05, Wis. Adm. Code, which sets forth the minimum standards for the handling of cash and recording of cash transactions by town mutual insurance companies. The examiners noted the following:

1. A proper policy register is maintained
2. A proper cash receipts journal is maintained
3. A proper cash disbursements journal is maintained
4. A proper general journal is maintained
5. A proper general ledger is maintained

An extensive review was made of income and disbursement items. Cash receipts were traced from source records and the proper recording and eventual deposit thereof ascertained. Negotiated checks issued during the period under examination were reviewed for proper endorsement, and traced to cash records. The verification of assets and determination of liabilities were made as of December 31, 2003.

The company is audited annually by an outside public accounting firm.

EDP Environment

Company personnel were interviewed with respect to the company's electronic data processing environment. Access to the computers is limited to people authorized to use the computers. Company personnel back up the computers daily and the backed-up data is kept off-site. Manuals which describe how to use the company's software and outlines the steps to complete specific tasks assists in the continuity of operations for seldom-used applications, training, or when staff turnover occurs. The company has manuals documenting the use of its software.

Business Continuity Plan

A business continuity plan identifies steps to be performed by a company in the event of business interruptions including, but not limited to, the inability to access its computer, the loss of information on its computer, the loss of a key employee, or the destruction of its office building. The company has developed a business continuity plan. The company's business continuity plan appears to be adequate.

Invested Assets

Section 610.23, Wis. Stat., requires insurers to hold all investments and deposits of its funds in its own name except that:

(1) Securities kept under a custodial agreement or trust arrangement with a bank or banking and trust company may be issued in the name of a nominee of the bank or banking and trust company; and

(2) Any insurer may acquire and hold securities in bearer form.

For securities not held under a custodial agreement or trust arrangement with a bank or banking and trust company, s. Ins 13.05 (4), Wis. Adm. Code, requires that:

> Non-negotiable evidences of company investments such as registered bonds, certificates of deposits, notes, etc., shall be maintained in a safe or vault with adequate safety controls or in a safety deposit box in a bank. Negotiable evidences of company investments shall be maintained in a safety deposit box in a bank. Access to a company safety deposit box

containing negotiable securities shall require the presence and signature of at least 2 officers, directors or employees of the company.

The company is in compliance with these requirements.

Investment Rule Compliance

The investment rule for town mutual insurers allows a company to invest in common stocks, common stock mutual funds, and other higher risk investments (referred to as "Type 2") provided that the town mutual has a sufficient amount of lower risk investments (referred to as "Type 1"). A town mutual may invest in Type 2 securities only if it already has sufficient Type 1 investments. Type 1 investments must equal or exceed the greater of items 1, 2, or 3.

1.	Liabilities plus $300,000	$1,143,417
2.	Liabilities plus 33% of gross premiums written	1,304,471
3.	Liabilities plus 50% of net premiums written	1,260,634
4.	Amount required (greater of 1, 2, or 3)	1,304,471
5.	Amount of Type 1 investments as of 12/31/2003	2,094,091
6.	Excess or (deficiency)	$ 789,620

The company has sufficient Type 1 investments.

ASSETS

Cash and Invested Cash **$206,507**

The above asset is comprised of the following types of cash items:

Cash in company's office	$ 100
Cash deposited in banks-checking accounts	203,100
Cash deposited in banks at interest	3,307
Total	$206,507

Cash in company's office at year-end represents the company's petty cash fund. A physical count was made by the examiners during the course of the examination and the balance reconciled to year-end.

Cash deposited in banks subject to the company's check and withdrawal consists of one account maintained at a local bank. Verification of the checking account balance was made by obtaining confirmation from the bank and reconciling the amount shown thereon to company records.

Cash deposited in banks at interest represents one deposit in a local bank. The deposit was verified by obtaining confirmation from the bank. Interest received during the year 2003 totaled $12 and was verified to company cash records. Rates of interest earned on this cash deposit ranged from .35% to .40%. There was no accrued interest on cash deposits at year-end.

Book Value of Bonds **$2,074,857**

The above asset consists of the aggregate book value of bonds held by the company as of December 31, 2003. Bonds owned by the company are located with their investment custodian or in a safe deposit box at their bank.

Bonds in the safe deposit box were inspected by the examiners. Bond purchases and sales for the period under examination were checked to brokers' invoices and advices. The company's investment in bonds was in conformance with Wisconsin Statutes and the rules of the Commissioner of Insurance as regards to investments made by town mutual insurers.

Interest received during 2003 on bonds amounted to $107,237 and was traced to cash receipts records. Accrued interest of $45,530 at December 31, 2003, was checked and allowed as a nonledger asset.

Stocks and Mutual Fund Investments **$1,485,430**

The above asset consists of the aggregate market value of stocks and mutual funds held by the company as of December 31, 2003. Stocks owned by the company are located with their investment custodian or in a safe deposit box at their bank.

Stock certificates were examined by the examiners. Stock and mutual fund purchases and sales for the period under examination were checked to brokers' invoices and advices. The company's investment in stocks and mutual funds was in conformance with Wisconsin Statutes and the rules of the Commissioner of Insurance as regards to investments made by town mutual insurers.

Dividends received during 2003 on stocks and mutual funds amounted to $58,864 and were traced to cash receipts records. There were no accrued dividends at December 31, 2003.

Premiums, Agents' Balances in Course of Collection **$27,768**

This asset represents the amounts due from policyholders which are not in excess of 90 days past due at year-end. A review of individual agent's accounts verified the accuracy of this asset.

Premiums Deferred and Not Yet Due **$134,655**

This asset represents modal premium installments (such as monthly, quarterly, etc.) that are not yet due. A review of a sample from the company's detailed list of deferred premiums verified the accuracy of this asset.

Investment Income Due and Accrued **$45,530**

This asset relates to interest due and accrued on the bonds owned by the company at December 31, 2003.

Reinsurance Recoverable on Paid Losses **$59,905**

The above asset represents recoveries due to the company from reinsurance on losses which were paid on or prior to December 31, 2003. A review of year-end accountings with the reinsurer verified the above asset.

Electronic Data Processing Equipment **$14,376**

The above balance consists of computer hardware and operating system software, net of depreciation, as of December 31, 2003. A review of receipts and other documentation verified the balance. While reviewing the detail of the computer depreciation it was determined that the company is depreciating its EDP equipment over various time periods ranging from three to seven years. SSAP 16 states that EDP equipment and software shall be depreciated for a period not to exceed three years. It is recommended that the company depreciate its EDP equipment in accordance with SSAP 16.

Non-operating system software was not properly nonadmitted. It was determined that the company has included a claims processing software in its admitted EDP assets. SSAP 16 and IP 16 state that non-operating system software meets the criteria defining nonadmitted assets; accordingly, such assets shall be reported as nonadmitted assets and charged against surplus. It is recommended that the company nonadmit the value of non-operating system software in future annual statements in accordance with SSAP 16.

Furniture and Fixtures **$0**

This asset consists of $8,233 of office furniture owned by the company at December 31, 2003. In accordance with annual statement requirements, this amount has been reported as a nonadmitted asset, thus the balance shown above is $0.

LIABILITIES AND SURPLUS

Net Unpaid Losses **$84,646**

This liability represents losses incurred on or prior to December 31, 2003, that remained unpaid as of that date. The examiners reviewed the reasonableness of this liability by totaling actual loss payments made subsequent to December 31, 2003, with incurred dates in 2003 and prior years. To the actual paid loss figure was added an estimated amount of $10,000 for 2003 and prior losses remaining unpaid at the time of the examination. The examiners' development of unpaid losses is compared with the amount estimated by the company in the following schedule.

	Company Estimate	Examiners' Development	Difference
Incurred but unpaid losses	$125,447	$41,804	$83,643
Less: Reinsurance recoverable on unpaid losses	40,801	6,335	34,466
Net Unpaid Losses	$ 84,646	$35,469	$49,177

The net difference is reflected in Section III of this report under the heading, "Reconciliation of Policyholders' Surplus."

The examiners' review of claim files included open claims, paid claims, claims closed without payment, and all claims which were denied during the examination period. The review indicated that claims are investigated and evaluated properly and that payments are made promptly and in accordance with policy provisions upon the submission of a proper proof of loss. In addition, the review of claims handling procedures and files revealed the following:

1. A proper loss register is maintained.
2. Claim files contained sufficient investigatory data and documentation to verify settlement payments or reserve estimates.
3. Proofs of loss were properly signed.

Unpaid Loss Adjustment Expenses **$1,250**

This liability represents the company's estimate of amounts necessary to settle losses which were incurred prior to December 31, 2003, but which remained unpaid as of year-end. The methodology used by the company in establishing this liability is historically based estimates.

The examiners' analysis of expenses incurred in the current year related to the settlement of prior year losses, as well as estimates of amounts necessary to settle any prior losses remaining unpaid at the examination date, determined this liability to be adequately stated.

Commissions Payable **$23,404**

This liability represents the commissions payable at December 31, 2003. The examiners reviewed the company's commission calculation and found the liability to be correctly calculated.

Fire Department Dues Payable **$942**

This liability represents the fire department dues payable at December 31, 2003. The examiners reviewed the company's fire department dues calculation and found this liability to be correctly calculated. The actual amount paid was verified to the cash disbursement records.

Unearned Premiums **$621,734**

This liability represents the reserve established for unearned premiums in compliance with s. Ins 13.08 (3), Wis. Adm. Code. This reserve was established using a daily pro rata methodology.

Reinsurance Payable **$83,668**

This liability consists of amounts due to the company's reinsurer at December 31, 2003, based upon the reinsurer's adjusted calculations, and the amount payable for deferred premium. Subsequent payments and confirmations with the reinsurer verified these amounts.

Class A Non-property	$18,982
Class C1 Excess of Loss	17,600
Class C2 Excess of Loss	3,500
Class D/E Stop Loss	19,500
Reinsurance Commission Payable	24,086
	$83,668

Amounts Withheld for the Account of Others **$186**

This liability represents employee payroll deductions in the possession of the company at December 31, 2003. Supporting records and subsequent cash disbursements verified this item.

Accounts Payable **$845**

This liability consists of amounts due to creditors for office and miscellaneous expenses at December 31, 2003. Supporting records and subsequent cash disbursements verified this item.

Deferred Compensation **$10,000**

This liability consists of amounts due to one retiring agent for the sale of his policies back to the company. Supporting documentation verified this item.

Premiums Received in Advance **$16,742**

This liability represents the total premiums received prior to year end for policies with effective dates after December 31, 2003. The examiners reviewed 2003 premium and cash receipt records to verify the accuracy of this liability. It was determined that the company had included some multiple payment plan payments in this figure. It is recommended that the company include as “Advance Premium” the premiums for policies that become effective subsequent to the receipt of the premium payment pursuant to the Town Mutual Annual Statement Instructions. No reclassification is made as this amount was below the examination’s materiality limit.

V. CONCLUSION

The company has had positive net income only once in the past five years and surplus has decreased 27% from the $4,364,221 reported at the last examination to $3,205,611 at December 31, 2003. Admitted assets decreased 16% to $4,049,028 over the same period. The decrease in surplus and assets can be attributed not only to high net loss and loss adjustment expense ratios, but also to high underwriting expense ratios. During the period under examination, the company's net loss and loss adjustment expense ratio has averaged 30 percentage points greater than the average for the Wisconsin town mutual industry as a whole. The company’s net underwriting expense ratio has been as high as 50 percentage points greater than the average for the Wisconsin town mutual industry as a whole and during the period under examination it averaged 37 percentage points greater than the average total for the Wisconsin town mutual industry. With the decline in interest rates, the company's investment income has been insufficient to offset underwriting and expense results as had been the case for some period of time prior to calendar year 1998. Management stated that they were aware of the company’s high net losses and loss adjustment expense ratios and high underwriting ratios and have sought to address this situation during the period under examination. Although in 2003 the company reported its first underwriting gain in the last ten years and its first positive net income during the period under examination, 2004 saw a resumption of the company’s adverse financial trend. OCI and the company’s management agree that there is more work to be done to reduce underwriting expenses.

There were three recommendations and one suggestion made as a result of this examination. The recommendations are related to improvements to the company's EDP asset accounting and premium reporting functions. The suggestion is related to the company’s need to address its high loss and underwriting expense ratios.

There was one adjustment to surplus as a result of this examination. The company's immediate financial position remains strong.

VI. SUMMARY OF COMMENTS AND RECOMMENDATIONS

1. Page 6 - Growth of Company—It is suggested that the board of directors and management of the company review pricing in relation to its loss and loss adjustment expense experience and necessary underwriting expenses in relation to the amount of business written.

2. Page 21 - EDP Equipment—It is recommended that the company depreciate its EDP equipment in accordance with SSAP 16.

3. Page 21 - EDP Equipment—It is recommended that the company nonadmit the value of non-operating system software in future annual statements in accordance with SSAP 16.

4. Page 24 - Premiums Received in Advance—It is recommended that the company include as "Advance Premium" the premiums for policies that become effective subsequent to the receipt of the premium payment pursuant to the Town Mutual Annual Statement Instructions.

VII. ACKNOWLEDGMENT

The courteous cooperation extended to the examiners by the company's personnel is hereby acknowledged.

In addition to the undersigned, Carina Toselli of the Office of the Commissioner of Insurance, State of Wisconsin, participated in the examination:

Respectfully submitted,

Russell, Lamb
Examiner-in-Charge